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SUBJECT: QIZ EXPORT DROP REINFORCES EGYPTIAN-ISRAELI EXPANSION  
REQUEST

REF: A. 2007 CAIRO 2903  
[1](#)B. 2007 CAIRO 3023  
[1](#)C. 2007 CAIRO 3022  
[1](#)D. 2007 CAIRO 3305

Sensitive but unclassified, not for Internet distribution.

[1](#)1. (SBU) SUMMARY: As we prepare for high-level visits to the region surrounding the 60th anniversary of Israel and the World Economic Forum in Egypt, Post recommends strong consideration of a joint Egyptian-Israeli request to expand the Qualified Industrial Zone (QIZ) into Upper Egypt. Expanding the program would bring significant political and economic benefit to the Egyptians, boost Israeli-Egyptian economic cooperation, and have no significant impact on the American economy. END SUMMARY.

[1](#)2. (U) Egyptian QIZ factories exported USD \$152 million in goods to the United States in the fourth quarter of 2007, a 19-percent drop from the peak quarterly export of USD \$188 million in the third quarter of 2007. While much of that drop is attributable to annual market cycles, the figure was also 9 percent below QIZ exports in the fourth quarter of 2006, representing the first quarter-on-quarter decline in the three-year history of the agreement. Egyptian industrialists attribute the decline to the slowing US economy and the falling dollar relative to the euro, which is luring Egyptian exporters to European markets. While QIZ food exports showed a slight up-tick, they continue to represent less than 1 percent of QIZ exports, which are almost exclusively pants, shirts, and other ready-made garments.

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Explosive growth slows, reverses  
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[1](#)3. (U) The GOE, GOI, and USG signed the QIZ agreement in 2004 to encourage Israeli-Egyptian economic cooperation by granting duty-free status

to Egyptian products that contain 11.7 percent Israeli content. The GOE also hoped that the agreement would allow Egypt to maintain its share of the US market following the expiry of its export quota under the Multi-Fibre Agreement in 2004. In response to Egyptian and Israeli concerns that the area initially designated for the QIZ was too small, USTR agreed to expand it in 2005 to cover additional factories in the Nile Delta and Suez Canal region. More than 100,000 Egyptians now work in QIZ factories.

14. (U) QIZ exports had increased since the inception of the program, but the rate of growth declined, constrained by a tightening skilled labor market, a shortage of economical Israeli inputs, and competition from other garment exporters to the United States (ref A). The quarter-on-quarter export growth rate fell steadily from 53 percent growth in the third quarter of 2006 (compared to the third quarter in 2005) to 6 percent growth in the third quarter of 2007 (compared to the third quarter of 2006) before falling to a 9-percent decline in the fourth quarter of 2007 (compared to the fourth quarter of 2006).

15. (U) Meanwhile, US exports to Egypt rose dramatically in 2007 to USD \$5.3

CAIRO 00000364 002 OF 003

billion, a 30-percent increase over the USD \$4.1 billion in US exports in 2006. Egyptian exports to the United States were flat in 2007, essentially unchanged from the USD \$2.4 billion in 2006. As a result, the US trade surplus increased 73 percent in 2007 to just under USD \$3 billion, according to Department of Commerce statistics.

16. (U) The fall in the dollar relative to the euro, and the accompanying decline of the Egyptian pound relative to the euro, has made exports to the EU, which has a preferential trade agreement with Egypt, more lucrative for Egyptian exporters. During the first seven months of 2007, the dollar value of ready-made garments exported to the United States hovered around \$60 million USD a month, while the dollar value of exports to Europe rose steadily from \$99 million in January to over \$120 million in July.

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Upper Egypt expansion?  
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17. (U) In response to these trends, GOE Minister of Trade and Industry Rachid Rachid and Israeli Minister of Industry, Trade and Labor Eliyahu Yishai agreed on Oct. 9, 2007, to reduce the required level of Israeli content to 10.5 percent (ref B) and to request that USTR expand the QIZ area to Upper Egypt (ref C). While both moves work in favor of the GOE, Israeli negotiators said they viewed the expansion of markets into Upper Egypt as a benefit to offset their reduced

export income due to the content reduction agreement (ref D).

18. (U) The GOE argues in a brief on the expansion proposal (which we submitted separately to the Department and USTR) that QIZ expansion would not have an immediate or dramatic effect on QIZ exports to the United States. The eight governorates of Upper Egypt are underdeveloped, accounting for only 13 percent of investment in Egypt while representing 27 percent of the population. According to GOE figures, Upper Egypt has a higher rate of poverty -- 34 percent, compared to 20 percent -- and a higher rate of illiteracy -- 43 percent, compared to 34 percent -- than the rest of Egypt.

19. (U) While the lack of existing infrastructure and industrial capacity would prevent rapid growth of QIZ exports from Upper Egypt, the GOE and Egyptian industrialists hope that access to a relatively untapped labor market and abundant land would allow for QIZ expansion, easing the pressure on capital and labor expenses in existing factories. The GOE has provided land grants and financial incentives to developers in the region in keeping with President Mubarak's pledges to rectify underdevelopment there.

110. (U) The GOE expects industrial development in Upper Egypt could lead to higher employment, higher standards of living, and reduced migration to Cairo and other urban centers in Egypt. The GOE argues that expanding the program would expand its political benefits, demonstrating to another region of the country the value of Egyptian-Israeli cooperation, while continued underdevelopment would breed instability and extremism.

CAIRO 00000364 003 OF 003

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COMMENT  
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111. (SBU) QIZ workers we meet have little or no appreciation of the political dynamics of the agreement. But they do know that QIZ means jobs, and thousands of them took to the streets to demand inclusion in the agreement at its onset. The GOE understands that logic, believing that expanding the QIZ into Upper Egypt will ultimately mean expanding employment. As a result, it has worked closely with the GOI to develop this request. The political benefit of improving Israeli-Egyptian relations will be long-term through the development of enduring business ties.

112. (SBU) QIZ expansion into Upper Egypt will not significantly broaden the base of QIZ exports beyond textiles. While some Egyptian food processors are considering QIZ development in Upper Egypt, we expect that the economics of the arrangement will continue to overwhelmingly favor exporters of ready-made garments. Only products that normally face high tariffs in the United States

benefit enough from the QIZ duty-free status to compensate for the extra expense of the Israeli inputs.

¶13. (SBU) However, that supports the GOE contention that QIZ expansion would not affect any domestic US industry; Egypt would continue to compete with China and other textile exporters for market share in the United States. Considering the economic constraints on QIZ exporters, as well as the business environment in Upper Egypt, it is unlikely that the region would account for more than single-digit increases in QIZ exports. QIZ expansion would, however, help move the US-Egyptian economic partnership from aid to trade at a time of declining ESF assistance. It would also strengthen key reformers in the cabinet -- notably Prime Minister Nazif and Trade Minister Rachid -- and strengthen official GOE-GOI relations when other regional dynamics are stressing them.

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